Economics Working Paper

# THE ETHICS OF CREATIVE ACCOUNTING

Oriol Amat *
and
John Blake **
and
Jack Dowds ***

December 1999

Keywords: Accounting, creative accounting, ethics
Journal of Economic Literature classification: M41

---

* Universitat Pompeu Fabra
** Central Lancashire University, England
*** Massey University, New Zealand

Abstract

The term 'creative accounting' can be defined in a number of ways. Initially we will offer this definition: 'a process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of a business'.

To investigate the ethical issues raised by creative accounting we will:

- Explore some definitions of creative accounting
- Consider the various ways in which creative accounting can be undertaken.
- Explore the range of reasons for a company's directors to engage in creative accounting.
- Review the ethical issues that arise in creative accounting.
- Report on surveys of auditors' perceptions of creative accounting in the UK, Spain and New Zealand.

# THE ETHICS OF CREATIVE ACCOUNTING

## INTRODUCTION

The term 'creative accounting' can be defined in a number of ways. Initially we will offer this definition: 'a process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of a business'.

To investigate the ethical issues raised by creative accounting we will:

- Explore some definitions of creative accounting
- Consider the various ways in which creative accounting can be undertaken.
- Explore the range of reasons for a company's directors to engage in creative accounting.
- Review the ethical issues that arise in creative accounting.
- Report on surveys of auditors' perceptions of creative accounting in the UK, Spain and New Zealand.

## DEFINITIONS

Four authors in the UK, each writing from a different perspective, have explored the issue of creative accunting.

Ian Griffiths, writing from the perspective of a business journalist, observes:

> Every company in the country is fiddling its profits. Every set of published accounts is based on books which have been gently cooked or completely roasted. The figures which are fed twice a year to the investing public have all been changed in order to protect the guilty. It is the biggest con trick since the Trojan horse. . . In fact this deception is all in perfectly good taste. It is totally legitimate. It is creative accounting. (1986:1)

Michael Jameson, writing from the perspective of the accountant, argues:

> The accounting process consists of dealing with many matters of judgement and of resolving conflicts between competing approaches to the presentation of the results of financial events and transactions... this flexibility provides opportunities for manipulation, deceit and misrepresentation. These activities - practised by the less scrupulous elements of the accounting profession - have come to be known as 'creative accounting'. (1988: 7-8)

Terry Smith reports on his experience as an investment analyst:

> We felt that much of the apparent growth in profits which had occurred in the 1980s was the result of accounting sleight of band rather than genuine economic growth, and we set out to expose the main techniques involved, and to give live examples of companies using those techniques. (1992:4)

Kamal Naser, presenting an academic view, offers this definition:

> Creative accounting is the transformation of financial accounting figures from what they actually are to what preparers desire by taking advantage of the existing rules and/or ignoring some or all of them. (1993:2)

It is interesting to observe that Naser perceives the accounting system in Anglo-Saxon countries as particularly prone to such manipulation because of the freedom of choice it permits. Two features are common to all four writers:

1 They perceive the incidence of creative accounting to be common.
2 They see creative accounting as a deceitful and undesirable practice.

The various methods of creative accounting can be considered to fall in four categories:

(1) Sometimes the accounting rules allow a company to choose between different accounting methods. In many countries, for example, a company is allowed to choose between a policy of writing off development expenditure as it occurs and amortising it over the life of the related project. A company can therefore choose the accounting policy that gives their preferred image.

(2) Certain entries in the accounts involve an unavoidable degree of estimation, judgement, and prediction. In some cases, such as the estimation of an asset's useful life made in order to calculate depreciation, these estimates are normally made inside the business and the creative accountant has the opportunity to err on the side of caution or optimism in making the estimate. Grover (1991 b) reports on the example of the film industry, where a decision has to be made on how to allocate film production costs. Initially, these are capitalised, and then should be amortised against related earnings. Grover discusses one film company, Orion pictures: 'Some studies are definitely more optimistic than others and Orion was always among the most optimistic. . . Orion would delay, sometimes for years, taking write-downs on films that didn't measure up' (1991b: 56).
In other cases an outside expert is normally employed to make estimates; for instance, an actuary would normally be employed to assess the prospective pension liability. In this case the creative accountant can manipulate the valuation both by the way in which the valuer is briefed and by choosing a valuer known to take a pessimistic or an optimistic view, as the accountant prefers.

(3) Artificial transactions can be entered into both to manipulate balance sheet amounts and to move profits between accounting periods. This is achieved by entering into two or more related transactions with an obliging third party, normally a bank. For example, supposing an arrangement is made to sell an asset to a bank then lease that asset back for the rest of its useful life. The sale price under such a 'sale and leaseback' can be pitched above or below the current value of the asset, because the difference can be compensated for by increased or reduced rentals.

(4) Genuine transactions can also be timed so as to give the desired impression in the accounts. As an example, suppose a business has an investment of £1 million at historic cost which can easily be sold for £3 million, being the current value. The managers of the business are free to choose in which year they sell the investment and so increase the profit in the accounts.

Accounting regulators who wish to curb creative accounting have to tackle each of these approaches in a different way:

(1) Scope for choice of accounting methods can be reduced by reducing the number of permitted accounting methods or by specifying circumstances in which each method should be used. Requiring consistency of use of methods also helps here, since a company choosing a method which produces the desired picture in one year will then be forced to use the same method in future circumstances where the result may be less favourable.

(2) Abuse of judgement can be curbed in two ways. One is to draft rules that minimise the use of judgement. Thus in the UK company accountants tended to use the 'extraordinary item' part of the profit and loss account for items they wished to avoid including in operating profit. The UK Accounting Standards Board (ASH) responded by effectively abolishing the category of 'extraordinary item'. Auditors also have a part to play in identifying dishonest estimates. The other is to prescribe 'consistency' so that if a company chooses an accounting policy that suits it in one year it must continue to apply it in subsequent years when it may not suit so well.

(3) Artificial transactions can be tackled by invoking the concept of 'substance over form', whereby the economic substance rather than the legal form of transactions determines their accounting substance. Thus linked transactions would be accounted for as one whole.

(4) The timing of genuine transactions is clearly a matter for the discretion of management. However, the scope to use this can be limited by requiring regular revaluations of items in the accounts so that gains or losses on value changes are identified in the accounts each year as they occur, rather than only appearing in total in the year that a disposal occurs. It is interesting to observe that, in their recent draft conceptual framework, the ASB have stated a wish to move towards increased use of revaluations rather than historic cost in the accounts.

We have seen above that creative accounting is seen as a particular feature of the Anglo-Saxon approach to accounting, with its scope for flexibility and judgement, rather than the continental European model, with its tradition of detailed prescription. However, as we show in Table 1, each of the two approaches offers greater support for the control of creative accounting in some respects and conversely, therefore, greater opportunity to engage in creative accounting in others. The more prescriptive and inflexible approach of the continental European model makes it easier to reduce the scope for abuse of choice of accounting policy and manipulation of accounting estimates. The less legal orientation of the Anglo-Saxon model is more conducive to the use of substance over form and revaluation.

*Table 1* Opportunities for creative accounting

| *Opportunity for creative accounting* | *Solution available to accounting regulator* | *Accounting tradition where solution is most easily applied* |
|---|---|---|
| Choice of accounting method | Reduce permitted choice | Continental European |
| Bias estimates and prediction | Reduce scope for estimate | Continental European |
| Enter into artificial transaction | Substance over form | Anglo-Saxon |
| Timing of genuine transactions | Prescribe revaluation | Anglo-Saxon |

## REASONS FOR CREATIVE ACCOUNTING

Discussions of creative accounting have focused mainly on the impact on decision of investors in the stock market. Reasons for the directors of listed companies to seek to manipulate the accounts are as follows.

(1) Income smoothing. Companies generally prefer to report a steady trend of growth in profit rather than to show volatile profits with a series of dramatic rises and falls. This is achieved by making unnecessarily high provisions for liabilities and against asset values in good years so that these provisions can be reduced, thereby improving reported profits, in bad years. Advocates of this approach argue that it is a measure against the 'short-termism' of judging an investment on the basis of the yields achieved in the immediate following years. It also avoids raising expectations so high in good years that the company is unable to deliver what is required subsequently. Against this is argued that:

- if the trading conditions of a business are in fact volatile then investors have a right to know this;
- income smoothing may conceal long-term changes in the profit trend.

This type of creative accounting is not special to the UK. In countries with highly conservative accounting systems the 'income smoothing' effect can be particularly pronounced because of the high level of provisions that accumulate. Blake *et al.* (1995) discuss a German example. Another bias that sometimes arises is called 'big bath' accounting, where a company making a bad loss seeks to maximise the reported loss in that year so that future years will appear better.

(2) A variant on income smoothing is to manipulate profit to tie in to forecasts. Fox (1997) reports on how accounting policies at Microsoft are designed, within the normal accounting rules, to match reported earnings to profit forecasts. When Microsoft sell software a large part of the profit is deferred to future years to cover potential upgrade and customer support costs. This perfectly respectable, and highly conservative, accounting policy means that future earnings are easy to predict.

(3) Company directors may keep an income-boosting accounting policy change in hand

to distract attention from unwelcome news. Collingwood (1991) reports on how a change in accounting method boosted K-Mart's quarterly profit figure by some $160 million, by a happy coincidence distracting attention from the company slipping back from being the largest retailer in the USA to the number two slot.

(4) Creative accounting may help maintain or boost the share price both by reducing the apparent levels of borrowing, so making the company appear subject to less risk, and by creating the appearance of a good profit trend. This helps the company to raise capital from new share issues, offer their own shares in takeover bids, and resist takeover by other companies.

(5) If the directors engage in 'insider dealing' in their company's shares they can use creative accounting to delay the release of information for the market, thereby enhancing their opportunity to benefit from inside knowledge.

It should be noted that, in an efficient market, analysts will not be fooled by cosmetic accounting charges. Indeed, the alert analyst will see income-boosting accounting changes as a possible indicator of weakness. Dharan and Lev (1993) report on a study showing poor share price performance in the years following income increasing accounting changes. Another set of reasons for creative accounting, which applies to all companies, arises because compaflies are subject to various forms of contractual rights, obligations and constraints based on the amounts reported in the accounts. Examples of such contractual issues are as follows.

***Example 1*** It is common for loan agreements to include a restriction on the total amount that a company is entitled to borrow computed as a multiple of the total share capital and reserves. Where a company has borrowings that are near this limit there is an incentive to:

- choose accounting methods that increase reported profit and consequently the reserves. (Sweeney (1994) reports that companies nearing violation of debt covenants are two to three times more likely to make income increasing accounting policy changes than other companies);
- arrange finance in a way that will not be reflected as a liability on the balance sheet.

An accounting rule change can plunge a company into difficulties with loan agreements. Thus in the USA, when the FASB introduced a rule requiring that income from extended warranties must be allocated over the life of the warranty rather than being recognised at the time of sale, consumer electronics retailers were badly hit:

> The biggest problem could be with the banks that keeps a close eye on debt to equity ratios ... so stores that borrowed heavily to build inventory and finance expansion could end up in technical violation of bank lending agreements pegged to certain ratios. (Therrien 1991:42)

***Example*** *2* Some companies, such as public utilities like electricity and telephone companies, are subject to the authority of a government regulator who prescribes the maximum amounts they can charge. If such companies report high profits then the regulator is likely to respond by curbing prices. These companies, therefore, have an interest in choosing accounting methods that tend to reduce their reported profits.

***Erample 3*** A directors' bonus scheme may be linked to profits or to the company share price.

where the link is to the share price then clearly the directors will be motivated to present accounts that will impress the stock market. Where a bonus is based on reported profit the scheme often stipulates that the bonus is a percentage of profit above a minimum level, and is paid up to a maximum level.
Thus:

1 If the profit figure is between the two levels then directors will choose accounting methods that lift profit towards the maximum.
2 If the profit is below the minimum level directors will choose accounting methods that maximise provisions made so that in future years these provisions can be written back to boost profit.
3 Similarly if the profit is above the maximum level directors wifl seek to bring the figure down to that level so that the profit can be boosted in later years.

The timing of the announcement of gains and losses can have a major impact on bonuses. In January 1991 Westinghouse announced unaudited record earnings of $1 billion and related hefty bonuses; in February 1991 bad debt write-offs of $975 million were announced, putting the legitimacy of bonuses in question (Schroeder and Spiro 1992).

***Example 4*** Where a part or division of a business is subject to a profit-sharing arrangement then this may affect the preferred accounting methods. In the UK, for example, we know of a local council that had a contract with a company for the company to manage the council's leisure centre. The contract provided for profits to be shared equally between the two parties. At the end of one year; not surprisingly the company's accountants said the centre had made a loss and the council's accountants said it had made a profit. The problem was solved by an agreement for the company to pay a fixed amount of money each year instead of a profit share. In the USA film companies have been notorious for claiming massive expenses against successful films so that writers, producers, and actors on 'net profit' deals receive little or no remuneration (Grover 199 la).

***Example 5*** Taxation may also be a factor in creative accounting in those circumstances where taxable income is measured by relation to the accounting figures.

***Example*** 6 When a new manager takes over responsibility for a unit there is a motivation to make provisions that ensure that any losses appear as the responsibility of the previous manager. Dahi (1996) reports on a survey of US bank managers that found provisions for loan losses tended to be higher in the year of change in manager

## THE ETHICAL PERSF'ECTIVE

Revsine (1991) offers a discussion of the 'selective financial misrepresentation hypothesis' which can be seen as offering some defence for the practice of 'creative accounting', at least in the private sector, drawing heavily on the literature on agency theory and positive accounting theory. He considers the problem in relation to both managers and shareholders and argues that each can draw benefits from 'loose' accounting standards that provide managers with latitude in timing the reporting of income.
Revsine discusses the benefits to managers in being able to manipulate income between years so as to maximise their bonus entitlements, as discussed above. He argues that:

It is reasonable to presume that those who negotiate managers employment contracts anticipate such opportunistic behaviour and reduce the compensation package accordingly ... since they (managers) have already been 'charged' for the opportunistic actions they must now engage in them in order to achieve the benefits they 'paid' for (1991:18)

Shareholders also benefit from the fact that managers can manipulate reported earnings to 'smooth' income since this may decrease the apparent volatility of earnings and so increase the value of their shares. Other management action, such as avoiding default on loan agreements, can also benefit shareholders.
At the heart of Revsine's analysis are the implicit views that:

- the prime role of accounting is as a mechanism for monitoring contracts between managers and other groups providing finance;

- market mechanisms will operate efficiently, identifying the prospect of accounting manipulation and reflecting this appropriately in pricing and contracting decisions.

On this basis he argues for freezing all existing accounting standards in the private sector, to be used as 'the basis for all future contracting and reporting'. Instead future FASB work should be applied to the public sector, including institutions such as the savings and loans where publicly funded guarantees underpin their activity. This focus is necessary because 'market discipline is muted in the public sector and perpetrators of financial misrepresentations confront fewer obstacles' (24-5).
The literature on the ethics of bias in accounting policy choice is reviewed at the 'macro' level of the accounting regulator. This literature can similarly be applied to the bias in accounting policy choice at the 'micro' level of the management of individual companies that is implicit in creative accounting. If we consider the position taken by Ruland (1984) and compare it to Revsine's analysis, we note the following.

(1) Ruland distinguishes between the deontological view whereby moral rules apply to actual actions and the teleological view that an action should be judged on the basis of the moral worth of the outcome. Revsine appears to take a teleological view of accounting in the private sector, allowing managers to choose between the alternatives permitted in 'loose' standards to achieve their desired end, but to take a deontological view of accounting in the public sector where he calls for tighter standards to prevent such manipulation. We might ask whether the presence or absence of market discipline justifies such ethical inconsistency.

(2) Ruland also discusses the distinction between a 'positive' responsibility, which here would be the duty to present unbiased accounts, and a 'negative' responsibility where managers would be responsible for states of affairs they fail to prevent. As we have seen, Ruland gives priority to the 'positive'. Within Revsine's framework, where all outcomes are deemed to be impounded in the process of contracting and price-setting, the distinction is not acknowledged.

(3) The 'duty to refrain' would imply avoiding the bias inherent in creative accounting while the 'duty to act' would involve pursuing the consequences to be achieved by creative accounting. If we take the three issues where Ruland sees the 'duty to refrain' as the more important:

(a) Relentlessness and
(b) Certainty of outcome: Revsine's arguments, as we have seen, apply to a limited role for accounting as a primarily contract monitoring exercise.
(c) Responsibility: Revsine seems to see compliance with GAAP as the prime responsibility, with no constraint on choice within GAAP. This may be a legitimate approach in the USA, but in a jurisdiction that prescribes an overriding qualitative objective for accounts, such as the European Union with 'true and fair view', Revsine's approach is less defensible.

To the professional accountant creative accounting generally seems to be regarded as ethically dubious. In the USA the then senior partner of Price Waterhouse observed:

When fraudulent reporting occurs, it frequently is perpetrated at levels of management above those for which internal control systems are designed to be effective. It often involves using the financial statements to create an illusion that the entity is healthier and more prosperous than it actually is. This illusion sometimes is accomplished by masking economic realities through intentional misapplication of accounting principles. (Conner 1986: 78)

Note the term 'fraudulent' used here to describe creative accounting. In Australia Leung and Cooper (1995) found that in a survey of 1500 accountants the three ethical problems cited most frequently were as shown in Table 2.

It is striking that the creative accounting issue ranks above tax evasion as an ethical issue for Australian practitioners. Two surveys of attitudes to creative accounting in the USA both highlight a difference in accountants attitudes to creative accounting depending on whether it arises from abuse of accounting rules or from the manipulation of transactions. Fischer and Rosenzweig (1995) found that accounting and MBA students were more critical than accounting practitioners of manipulated transactions, whereas accounting practitioners were more critical than students of abuse of accounting rules.

*Table 2* Three most frequently cited ethical problems

| | *% of respondents* |
|---|---|
| *Conflict of interest* | *51.9* |
| *Client proposal to manipulate accounts* | *50.1* |
| *Client proposals for tax evasion* | *46.8* |

*Source: Leung and Cooper (1995)*

Merchant and Rockness (1994) similarly found that, when presented with scenarios of creative accounting, accountants were more critical of abuse of accounting rules than of manipulation of transactions. Fischer and Rosenzweig offer two possible explanations for accountants' attitudes:

1 Accountants may take a rule-based apprroach to ethics, rather on the impact on users of the accounts.

2 Accountants may see abuse of accounting rules as fatling within their domain, and therefore demanding their ethical judgement, while the manipulation of transactions falls within the domain of management and so is not subject to the same ethical code.

Merchant and Rockness also found a difference in accountants' attitudes to creative accounting depending on the motivation of management. Creative accounting based on explicit motives of self-interest attracted more disapproval than where the motivation was to promote the company.

An accountant, or other manager, who takes a stand against creative accounting faces the same pressures as any other whistleblower. In extreme cases failure to act could ruin a reputation. As one company accountant who took a firm stand put it: 'It cost me my job, but I don't think I would have gotten another job had I been unethical' (quoted by Baldo 1995).

Schilit (1993) reports the case of one company accountant confronted with such an issue. His employer; a food wholesaler, incurred substantial costs in paying retailers to put new lines on their shelves. This is a common practice, known as 'slotting', and the costs are commonly written off in the year they are incurred. In order to keep within accounting ratios under loan agreements the company president proposed to capitalise the slotting costs and amortise them over ten years. The accountant:

1 Undertook some research on other company practices, and as a result was confirmed in the view that this was not an acceptable accounting treatment.

2 Identified cost savings that would have just kept the company inside its loan agreement.

3 Alerted the auditors to the issue, hoping 'that they would play the role of bad cop and force the company to expense the 'slotting'.

The principal investor in the company tried, unsuccessfully, to put pressure on the auditor to support the capitalisation of the slotting costs. Shortly after the accountant was sacked for taking this stand. The series of actions in this case are revealing:

1 Check that the proposed accounting method is in fact unacceptable. As Hamilton advises:

> First, try to verify your suspicions about what you think is wrong. Some accounting practices that are legal under new laws may look suspect to a non accountant... If you blow the whistle on something that's not illegal, you're really bare and perhaps even vulnerable to defamation claims. (1991: l38-9)

2 Search for alternative legitimate ways to achieve the desired end and offer these as an alternative approach to management.
3 In the last resort, report the abuse to the appropriate monitor.

## IS THERE A SOLUTION?

Questionnaire surveys of auditors' views on creative accounting have been conducted in the UK (Naser 1993) and Spain (Amat and Blake 1996). Table 3 shows a substantial minority of auditors in each country taking a tolerant view of creative accounting. In Spain there seems to be more optimism on prospects for resolving the problem. Given that Spain has only had a comprehensive set of rules for auditing and financial reporting since 1990, this may reflect inexperience of the problems. A survey of Spanish attitudes to accounting and auditing reports that they 'appear' quite innocent (Garcia Benau and Humphrey 1992:313).

*Table 3* Summary of results of surveys of auditors' attitudes to creative accounting

| *Agreement with the proposition:* | *UK %* | *Spain %* |
|---|---|---|
| *The use of creative accounting is a legitimate business tool* | *36* | *31* |
| *Creative accounting is a problem that can never* be solved | *91* | *38* |

*Source:* Taken from Naser (1993) and Amat and Blake (1996)

New Zealand has acquired, during the 1990s, an accounting regulatory system designed to strengthen accounting standards. In 1974 the New Zealand Society of Accountants (NZSA), now the Institute of Chartered Accountants of New Zealand (ICANZ), started to issue accounting standards which were binding on its members. In 1987 the stock market crash saw the demise of several large and many smaller firms listed on the New Zealand Stock Exchange; in the aftermath the need for a new company and accounting regulatory regime was seen, leading to the Financial Reporting Act and the new Companies Act, both in 1993 (Rahman and Perera 1997:135-6). The New Zealand Society of Accountants continues to set Financial Reporting Standards (FRSs). These must be submitted for approval to the Accounting Standards Review Board (ASRB), a body appointed by the government. The basic accounting requirement is that accounts should comply with 'Generally Accepted Accounting Practice' (GAAP). Accounts comply with GAAP:

1 when they comply with applicable Financial Reporting Standards
2 when a matter is not dealt with in an applicable Financial Reporting Standard, they follow accounting policies which:

- are appropriate to the circumstances of the entity; and
- have authoritative support within the New Zealand accounting profession. (See Simpkins 1994.)

The registrar of companies is charged with enforcement of the Act. Noncompliance can render directors liable for fines of up to NZ$100,000. Emery (1994) sees adequate resourcing of the registrar in this role as an essential condition for the smooth running of the new system.
To investigate the impact of this new system on creative accounting we approached both the 'Big Six' firms and those firms with more than four partners having an international association in each of Auckland, Christchurch and Wellington. We undertook fifteen interviews, ten with Big Six and five with other firms.
Table 4 shows an almost unanimous view that creative accounting is not now a significant problem in New Zealand, and Table 2.5 shows a similar consensus that there has been a reduction in its practice. Responses to the question of why it was thought that there had been a reduction are shown in Table 6.
We have analysed the responses by dividing them into two parts:

1 Reasons brought about by the profession or government. The main factors here is the new regulatory framework, but the profession's own actions in improving technical standards is also seen as a factor.
2 Directors' own responses, both with concern to litigation risk and to becoming aware that users have 'got wise' to creative accounting.

Both the interviewees who saw some revival in creative accounting were concerned that the lessons of 1987 crash were being forgotten.

*Table 4* Is creative accounting a significant problem in New Zealand?

| | | |
|---|---|---|
| YES | 1 | 7 |
| NO | 14 | 93 |
| | 15 | 100 |

*Table 5* Is creative accounting becoming more or less common in New Zealand?

| | | % |
|---|---|---|
| Much reduced | 11 | 73 |
| Some reduction | 1 | 7 |
| Unchanged | 1 | 7 |
| Much reduced from past but now slight revival | 2 | 13 |
| | 15 | 100 |

*Table 6* Reasons put forward to explain a reduction in creative accounting

| | |
|---|---|
| The new structure of financial regulation | 5 |
| Use of 'Generally Accepted Accounting Practice' as term | 1 |
| The setting up of technical departments by the big audit firms | 1 |
| New Zealand as a small country, where informal contacts avoid 'opinion shopping' | 1 |
| | 8 |
| Directors' response to the stock exchange crash | 2 |
| Directors more sophisticated | 1 |
| Directors more ethical | 1 |
| Users more knowledgeable | 1 |
| No need in a strong economy | 1 |
| | ***6*** |
| | 14 |

## CONCLUSION

Creative accounting offers a formidable challenge to the accounting profession. The problem is an international one, with accounting policy choice being a particular problem in the Anglo-American tradition and transaction manipulation a particular problem in the continental European tradition. There is a wide variety of motivations for managers to engage in creative accounting. The justification for creative accounting put forward in the 'positive accounting theory' tradition is:

- In conflict with mainstream thinking on ethics.
- Particularly relevant to the USA, where there is a well-developed stock market and a focus on detailed accounting regulation rather than broad principles, and is considerably less
- elevant in other countries.

Accountants who accept the ethical challenge that creative accounting raises need to be aware of the scope for both abuse of accounting policy choice and manipulation of transactions.
New Zealand offers an example of a country where a well-designed framework of accounting regulation has curbed creative accounting. However, our interviews raised some concerns as to whether this situation will last.

## REFERENCES


Amat, 0. and Blake, J. (1996) ***Contabdidad*** *Creativa,* Barcelona: Gestión 2000.

Baldo, A. (1995) 'What's right? What's wrong?', *Treasury and Risk Management,* November.

Blake, J., Amat, 0., Martinez, D. and Garcia, F. (1995) 'The continuing problem of international accounting diversity', ***Company*** *Accountant,* April: 23-5.

Collingwocd, H. (1991) 'Why K-Mart's good news isn't', *Rusiness Week,* March 18:40.

Conner, I.E. (1986) 'Enhancing public confidence in the accounting profession', *Journal of Accountancy,* July; 7683.

Dahi, D.. (1996) 'Managerial turnover and successor accounting discretion: bank loan loss provisions afler resignation, retirement, or death', *Research in Aa'ounting Regulation,* 10: 95-110.

Dharan, B. and Lev, B. (1993) 'The valuation consequence of accounting charges: a multi-year examination', *Journal of Accounting Auditing and finance, 8 (4):* 475-94.

Emery, M. (1994) 'New Zealand's new structure - an international comparison'. ***Accountants' Journal, 73*** (2): 65-S.

Fischer; M. and Rosenzweig, K. (1995) Attitudes of students and accounting practitioners concerning the ethical acceptability of earnings management', ***Journal of Business Ethics,*** 14: 433-44.

Fox, J. (1997) 'Learn to play the Earnings Game', *Fortune,* 31 July.

Garcia Benau, M.A. and Humphrey, C. (1992) 'Beyond the audit expectations gap: learning from the experiences of Britain and Spain' *European Accounting Review,* 1: 303-31.

Griffiths, 1(1986) *Creative Accounting,* London: Sidgwick & Jackson.

Grover, R. (1991a) 'Curtains for tinsel town accounting?', *Business Week,* 14 January: 35.

--(1991b) 'Dances with debts: why Orion is reeling', *Business Week,* 12 August: 56.

Hamilton, J. (1991) 'Blowing the whistle without paying the piper', *Business Week,* 3 June: 138.

Jameson, M. (1988) *Practical Guide to Creative Accounting,* London: Kogan Page.

Leung, F and Cooper, B. (1995) 'Ethical dilemmas in accountancy practice', *Australian Accountant,* May: 28-33.

Merchant, K.A. and Rocknes, J. (1994) 'The ethics of managing earnings: an empirical investigation', *Journal of Accounting and Public Polky,* 13: 79-94.

Naser, K. (1993) *Creative Financial Accounting: Its Nature and Use,* Hemel Hempstead: Prentice Hall.

Rahman, A.R. and Penera, M,H.B. (1997) Accounting and its environment in New Zealand', in N. Baydoun, A. Nishimura, and R. Willet, *Accounting in the Asia-Pacific Region,* Singapore: John Wiley (Asia), 127-57.

Revsine, L. (1991) 'The selective financial misrepresentation hypothesis', *Accounting Horizons,* December: l6-27.

Ruland, R.G. (1984) 'Duty, obligation and responsibility in accounting policy making', *Journal of Accounting and Public Policy,* Fall: 223-37.

Schilit, H.M. (1997) 'Is it fraud or just slick accounting?', *CEO Magazine,* August.

Schroeder, M. and Spiro, L.N. (1992) 'Does everything add up at Westinghouse Credit?', *Business Week,* 11 May: 80-3.

Simpkins, K. (1994) 'Financial Reporting Act 1993: key requirements', *Accountants' Journal,* 73 (3)15-19.

Smith, T. (1992) *Accounting for Growth*, London: Century Business.

Sweeney, A.P. (1994) 'Debt covenant violations and managers' accounting responses', *Journal of Accounting and Economics*, 17: 281-308.

Therrien, L. (1991) 'Electronics stores get a cruel shock', *Business Week*, 14 January: 42.